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DEPARTMENT OF TRANSPORTATION

Office of the Secretary

14 CFR Part 204 and 14 CFR Part 399

Docket No. OST-03-15759 – 15

RIN: 2105-AD25

DEPT. OF TRANSPORTATION
DOCKETS
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TITLE: Actual control of U.S. air carriers.

AGENCY: Office of the Secretary, DOT.

ACTION: Notice of proposed rulemaking (NPRM); request for comments.

SUMMARY: The Department is seeking comments on a proposal to clarify policies that may be used during initial and continuing fitness reviews of U.S. carriers when citizenship is at issue. We propose to add a new section to 14 CFR Part 399 that clarifies how the Department will interpret "actual control" of a U.S. air carrier during fitness reviews. This proposal will affect how we interpret the circumstances influencing a determination of "actual control," allowing easier access to foreign capital for U.S. airlines. We are also proposing minor amendments to 14 CFR Part 204 to reference the new section and update existing language in Part 204.

DATES: Comments are due on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may send comments identified by DMS Docket No. OST-03-15759 using any of the following methods:

* Website: http://dms.dot.gov Follow the instructions for submitting comments on the DOT electronic docket site.

* Fax: 1-202-493-2251

* Federal eRulemaking Portal: http://www.regulations.gov Follow the instructions for submitting comments.

* Mail: Docket Operations, U.S. Department of Transportation, 400 Seventh Street, S.W., Nassif Building, Room PL-401, Washington, DC 20590-0001.

* Hand Delivery: Room PL-401 on the plaza level of the Nassif Building, 400 Seventh Street, SW, Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

Instructions: All submissions must include the agency name and docket number or Regulatory Identification Number for this rulemaking. For detailed instructions on submitting comments and additional information on the rulemaking process, see the Public Participation heading in the Supplementary Information section of this document. Note that all comments received will be posted without change to http://dms.dot.gov, including any personal information provided. Please see the Privacy Act heading under Supplementary Information for further information.

Docket: For access to the docket to read background documents or comments received, go to http://dms.dot.gov at any time or to Room PL-401 on the plaza level of the Nassif Building, 400 Seventh Street, SW, Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: William M. Bertram, Chief, Air Carrier Fitness Division, Department of Transportation, 400 Seventh Street, SW, Washington, DC 20590. Telephone: (202) 366-9721.

SUPPLEMENTARY INFORMATION:

Comments Invited: The Department invites interested persons to participate in this rulemaking by submitting written comments, data, or views. We also invite comments

relating to any economic, environmental, energy, or federalism impacts that might result from adopting the proposals in this document. The most helpful comments will reference a specific portion of the proposal, explain the reason for any recommended change, and include supporting data.

Public Participation

The DMS is available 24 hours each day, 365 days each year. You can get electronic submission and retrieval help and guidelines under the "help" section of the DMS web site. If you want us to notify you that we received your comments, please include a self-addressed, stamped envelope or postcard or print the acknowledge page that appears after submitting comments on-line.

Comments received after the comment closing date will be included in the docket, and we will consider late comments to the extent practicable.

Privacy Act: Using the search function of our docket web site, anyone can find and read the comments received in any of our dockets, including the name of the individual sending the comment (or signing the comment on behalf of an association, business, labor union, etc.). You may review the Department's complete Privacy Act Statement in the Federal Register published on April 11, 2000 (65 FR 19477-78), or you may visit http://dms.dot.gov.

Background

Air carriers must have authority granted to them by the Department to operate in the United States as U.S. air carriers. Under 14 CFR § 204.5, certificated and commuter air carriers that undergo or propose to undergo a substantial change in operations, ownership, or

management must submit certain updated fitness information to the Department.[1] Section 204.5(c) of our regulations specifies that, if such information is being filed in support of an application for new or amended certificate authority, it will be filed in the docket as part of a public proceeding. For example, a certificated or commuter air carrier must apply for new or amended authority if its existing authority is not adequate for the performance of its planned service (*e.g.*, if a carrier wishes to serve a new city-pair route in foreign scheduled air transportation, if a carrier holding all-cargo authority wishes to conduct passenger service, or if a carrier currently operating only small aircraft wishes to operate large aircraft). If the substantial change being proposed does not affect the carrier's authority to perform its service under its existing authority, then the information is reported directly to the Chief of the Air Carrier Fitness Division, and is reviewed without a public proceeding as part of an informal continuing fitness investigation. Substantial changes that may not require a carrier to apply for new or amended authority include changes in the carrier's ownership or management. The purpose of these informal reviews is to decide whether a more formal, public proceeding is warranted, and whether the carrier's authority should be modified, suspended, revoked, or subjected to an enforcement action. During a continuing fitness review, the Department's staff may examine the carrier's ownership structure, and determine whether the air carrier continues to satisfy all statutory citizenship tests and continues to be under the actual control of U.S. citizens.

A citizen of the United States is defined in 49 U.S.C. § 40102(a)(15) as:

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[1] 14 CFR § 204.2(l) defines *substantial change in operations, ownership, or management* as including, but not limited to, the following events: "(1) changes in operations from charter to scheduled service, cargo to passenger service, short-haul to long-haul service, or (for a certificated air carrier) small-aircraft to large-aircraft operations; (2) the filing of a petition for reorganization or a plan of reorganization under Chapter 11 of the federal bankruptcy laws; (3) the acquisition by a new shareholder or the accumulation by an existing shareholder of beneficial control of 10 percent or more of the outstanding voting stock in the corporation; and (4) a change in the president, chief executive officer or chief operating officer, and/or a change in at least half of the other key personnel within any 12-month period or since its latest fitness review, whichever is the more recent period."

A) an individual who is a citizen of the United States;

B) a partnership each of whose partners is an individual who is a citizen of the United States; or

C) a corporation or association organized under the laws of the United States or a state, the District of Columbia, or a territory or possession of the United States, of which the president and at least two-thirds of the board of directors and other managing officers are citizens of the United States, which is under the actual control of citizens of the United States, and in which at least 75% of the voting interest is owned or controlled by persons that are citizens of the United States.

To be licensed, an airline that is, or is owned by, a corporation must be under the "actual control" of U.S. citizens to meet or continue to meet the citizenship standard. For many years, the standard and scope was refined through administrative case law dating back to 1940, first by the Civil Aeronautics Board (CAB) and then, after the CAB's sunset in 1984, by the Department of Transportation.[2] In 2004, "actual control" was specifically codified in the statutory definition of a citizen of the United States reflecting Departmental precedent, but it remains for the Department to interpret that requirement.[3] As part of the fitness review, the Department reviews the totality of circumstances of an airline's organization, including its capital structure, management, and contractual relationships, to ensure its compliance with the "actual control" requirement before issuing an air carrier license, and thereafter as its circumstances change.

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[2] Past cases include *In the matter of the citizenship of DHL Airways, Inc. n/k/a ASTAR Air Cargo, Inc.,* Order 2004-5-10, issued May 13, 2004 at 8; *Acquisition of Northwest Airlines by Wings Holdings, Inc.*, Order 89-9-51, issued September 29, 1989, at 5; *Application of Discovery Airways, Inc.*, Order 89-12-41, issued December 22, 1989, at 10; *In the matter of USAir and British Airways*, Order 93-3-17, issued March 15, 1993, at 19; and *Application of North American Airlines, Inc.*, Order 89-11-8, issued November 6, 1989, at 6.

[3] *See* 49 U.S.C. § 40102(a)(15), *as amended by* Vision 100 – Century of Aviation Reauthorization Act, P.L. 108-176, § 807, 117 Stat. 2490 (2004).

On March 4, 2003, the Inspector General of the U.S. Department of Transportation issued a letter in response to a request by the Chairman of the House Transportation and Infrastructure Committee to review the Department's procedures for making air carrier citizenship determinations in continuing fitness reviews, and to review the Department's consideration of a docketed proceeding then-pending before the Department (*In the matter of the citizenship of DHL Airways, Inc.*, Docket OST-2002-13089-32). In the letter, the Inspector General made two recommendations. First, the Department should publicly address the factors used to determine whether an air carrier is under the "actual control" of U.S. citizens. Second, the Department should consider modifying its procedures and regulations for reviewing an air carrier's citizenship status during a continuing fitness review.

1. Advance Notice of Proposed Rulemaking

On July 30, 2003, the Department published an ANPRM in the Federal Register (68 FR 44675-78) seeking comments on the two recommendations contained in the Inspector General's letter not directly related to the DHL case.

The Inspector General stated in his letter, "There are seven factors that frequently recur in past orders of the Department addressing the issue of actual control. These factors, while known to Department and aviation attorneys, have not been delineated in any one public document. Good public policy would suggest that the Department address these and other factors in a document that is widely available." The seven factors cited were: (1) control via supermajority or disproportionate voting rights; (2) negative control/power to veto; (3) buy-out clauses; (4) equity ownership; (5) significant contracts; (6) credit agreements/debt; and (7) family relationships/business relationships. We sought comments on whether there are other factors or criteria that the Department routinely considers in addition to those listed above. In doing so, however, we noted that the Department has

repeatedly stated in decisions that citizenship determinations necessarily are made on a case-by-case basis because every case has its own unique set of circumstances, and no single list of factors or criteria could be exhaustive, due to the changing legal and market circumstances faced by carriers when organizing their corporate and financial structures.

The Inspector General further stated that "[t]he informal process used for citizenship reviews can be beneficial when the issues are not complex or contentious by providing for open dialogue between the Department and carriers to resolve matters expeditiously." The Inspector General recommended that: "for the future, we believe the Department should give consideration to a more transparent and formal process in complex and contentious cases."

In the ANPRM, we asked for comments on the following questions:

(1) Is the Department's current informal, undocketed process for reviewing the citizenship of certificated and commuter air carriers following a substantial change in operations, ownership, or management sufficient to meet the statutory goals and requirements of evaluating a carrier's continuing fitness prior to any decision to take public action?

(2) Should air carriers proposing a substantial change in operations, ownership, or management that may affect their citizenship status be subject to a formal, public review of their citizenship, and if so, under what circumstances?

(3) What are the benefits and burdens, including time, effort, or financial resources expended, to generate, maintain, or provide information that would be subject to such a docketed public review? How would an air carrier's ability to obtain timely financing be affected?

(4) What are the advantages and disadvantages of retaining the current rule at 14 CFR 204.5 without revision?

(5) Should the Department establish separate procedures for handing complex, contentious, and controversial citizenship questions that arise in the context of continuing fitness reviews? If so, what procedures would be appropriate, and what standards should be used to designate such cases?

(6) Should the Department issue a public notice when it initiates and/or completes a citizenship determination in the context of a continuing fitness review? How would such notice impact an air carrier's business? What impact would such notice have on the willingness of an air carrier contemplating a future change in ownership, operations, and/or management to have candid discussions with the Department before formalizing any transaction?

(7) How should competition issues and business confidentiality issues be addressed in any change to the current procedures?

We have decided to respond to the Inspector General's concerns in three ways. First, as he suggested, we are publishing a more complete discussion of the citizenship and control factors, as well as a non-exclusive list of the criteria that have developed over time and that the Department has used in making citizenship and control determinations. The discussion is now available in the information packets *How to Become a Certificated Air Carrier* and *How to Become a Commuter Air Carrier* that can be downloaded by applicant carriers from the Assistant Secretary for Aviation and International Affair's website at http://ostpxweb.ost.dot.gov/aviation/index.html. Second, we are placing a separate discussion in a question and answer format on that web site. Third, we are proposing a Policy Statement about how we may interpret the actual control standard in application to an individual set of circumstances. As noted above, we are acting on a recommendation from the Inspector

General to place this information in a central location, and have incorporated some commenter suggestions as mentioned below.

2. Comments to the ANPRM

Comments to the ANPRM were due by September 29, 2003. We received 12 total comments to the ANPRM from 11 commenters. We received comments from ABX Air, Inc. ("ABX"), Air Line Pilots Association, International ("ALPA"), American Airlines, Inc. ("American"), ASTAR Air Cargo, Inc. ("ASTAR"), TEM Enterprises, Inc. d/b/a Casino Express Airlines and Murray Air, Inc. (joint filing) ("Casino/Murray"), Delta Air Lines, Inc. ("Delta"), Federal Express Corporation ("FedEx"), United Air Lines, Inc. ("United"), United Parcel Service Co. ("UPS"), Dr. Dorothy Robyn and Stephen L. Gelband (joint filing) ("Robyn/Gelband"), and Barbara Sachau ("Sachau").

Criteria for Determining Control

The commenters addressed the issues of whether the list of criteria as described in the Inspector General's letter should be codified in some form other than case precedents, and whether there are other factors or criteria that the Department routinely considers in making citizenship determinations that were not mentioned in the letter. In their comments, ABX, American, Delta, FedEx, United, and UPS stated that it would not be a good idea to codify the list in the regulations. ABX said that any list would hinder the Department's flexibility to address unique facts as the cases present themselves, an idea echoed in the comments of American and UPS. Delta commented that such a list would necessarily be suggestive of the most important factors while failing to be sufficiently comprehensive, and United commented that such a list could dictate the outcomes of certain investment and management structures, thereby limiting innovation and reactions to the dynamic aviation industry. FedEx commented that a significant body of precedent exists and there is no need to otherwise

articulate it. Casino/Murray advocated codifying the list of criteria, stating that it would be both appropriate and helpful to publish the list in some form that would be readily available to the public, such as in a policy statement in Part 399 of our regulations. ALPA commented that any list will serve only as a compilation of factors that have arisen in previous cases. Delta commented that it would have no objection to the Department publishing the list as *advisory* on an informal basis, such as on a website or other suitable location. UPS commented that the Department should make clear in any publication it may issue that no factor will be dispositive in the determination of a case.

FedEx, Robyn/Gelband, and UPS commented on other factors that we should consider in the preparation of any list for publication. FedEx suggested adding the foreign revenue test located in § 2710, P.L. 108-11. Applicable to air carriers applying for Department of Defense (DoD) airlift contracts, the provision states that a carrier would not be eligible for such a contract if more than 50% of its revenue came from a foreign source in the previous 3 years, and that foreign source, directly or indirectly, either owns a voting interest in the carrier or is owned by an agency or instrumentality of a foreign state. ABX responded to FedEx's comment in a supplemental filing, disputing the need to include the test when it only applies to DoD contracts and would break with longstanding Department precedent. Robyn/Gelband commented that any list should include the impact on competition, specifically the impact of bilateral relations with the country of which the foreign investor is a citizen and reciprocal market access. UPS suggested that the foreigner's power to cause reorganization of the carrier should be included in the list, because we already consider as a factor the foreigner's power to prevent reorganization.

3. Procedural Changes

We asked in the ANPRM for input on whether the Department should change its current informal, non-public process for evaluating citizenship in continuing fitness cases. Four commenters favored amending the regulations to allow for more public, formal procedures; seven commenters were opposed. Sachau commented that the public must be consulted on all matters, and that there should be a full public hearing. ALPA commented that the informal review process is inconsistent with the public review generally for fitness issues. The benefits of a public review of structural changes to a carrier's ownership outweigh potential burdens that could arise. ALPA suggested that provisions of Part 300, Subpart B, could be revised to accommodate continuing fitness reviews. FedEx believes that the process should be open and transparent, and that the Department should publish notice of every filing under § 204.5. Because most carriers are public companies, the carriers would be required to make similar filings with the SEC. Public reviews of the carrier's citizenship would begin upon request, and all relevant information would be placed in the docket. FedEx commented that third parties should be given the opportunity to show a case needs more than notice-and-comment, including more formal adjudicatory methods. UPS made three specific recommendations: (1) there should be public notice of the review in the Federal Register; (2) included in the notice would be a general summary of the facts omitting any confidential information; and (3) third parties should be afforded the opportunity to comment and review the materials under the Department's Rule 12 confidentiality requirements.

ABX, opposed to changing the regulations, commented that the Department experts were well-qualified to complete reviews without formal proceedings involving third parties. More public procedures would invite anticompetitive behavior in an effort to thwart market forces. American believes that the current approach is adequate provided the Department has

the discretion to establish more formal procedures when the situation arises. ASTAR also opposed changing the regulations, and stated that the informal process allows for an open exchange of information between the Department and the carrier. Like ABX's comment, ASTAR stated that more public proceedings would invite "anticompetitive mischief." Delta commented that it would be unnecessarily burdensome to promulgate a new set of formal procedures, and would hamper the Department's flexibility in resolving cases. Casino/Murray stated that the continuing fitness review process was not a mechanical exercise applying statutory formulas, but is flexible and the decisions are made subjectively. They further stated that the current system affords the Department the ability to use other procedures, and, similar to other commenters, noted that any public process could be subject to abuse by competitors. Robyn/Gelband pointed to the ASTAR hearing as an example of why the process should not be changed. They stated that there is no statutory requirement for public reviews of continuing fitness, and many cases may not be appropriate to review in a formal setting. Finally, United commented that the current process gives the Department the flexibility needed to accurately evaluate changes to a carrier's structure, and pointed out that the ASTAR case was an anomaly.

Four commenters also made specific comments regarding applying Rule 12 confidentiality to continuing fitness reviews if the process were to become more public. ABX commented that reviews often involve highly sensitive documents, and they should not be made available to third parties for potentially "illegitimate, anticompetitive attacks." ABX commented that the Department of Justice does not open up Hart-Scott-Rodino reviews for public commentary. ASTAR commented that permitting third parties to review confidential materials would stifle the open exchange of information with the Department, because currently carriers feel safe in knowing that competitors do not have access to their highly

confidential documents. Casino/Murray stated that Rule 12 is an option, but using it would still create a situation where a carrier's business relationships could be dangerously impaired at a time when the carrier is vulnerable. UPS commented that the Department should allow third parties to review documents under Rule 12 as part of a more public process.

Proposed Amendments

Continuing Fitness Procedures

As many of the commenters noted, the Department has various means at its disposal to initiate more formal proceedings when we believe such procedures to be appropriate while conducting a continuing fitness review. Requiring public notification every time there is a citizenship question resulting from a substantial change in ownership will not only dampen our ability to obtain confidential information and resolve issues informally with the carrier before a proposed transaction is finalized, but also may serve to deter investment or ownership changes because of the uncertainty surrounding a timely decision by the Department. In addition, such procedures could become extremely burdensome on the affected air carriers. For these reasons, we propose not to expand upon or be more specific as to the process used, but to continue to use those means already available. We invite public comment on our proposed decision here not to change our current processes in these matters.

"Actual Control" in Fitness Determinations

We have decided that this proposed rulemaking should consider whether the Department's interpretation of "actual control" should be changed to reflect the substantial structural changes that have taken place in global financial markets. This proposal is consistent with our obligation to foster a safe, healthy, and competitive airline industry that

will remain capable of supporting U.S. economic growth by meeting the public's transportation needs.[4]

So that the U.S. air transportation industry can continue to compete and be a leader in the ever-growing global economy, there needs to be enhanced access to worldwide financial resources. Accordingly, we propose to adapt our interpretation of how this private foreign capitalization affects the "actual control" of U.S. airlines to reflect these new realties.

U.S. aviation policy since deregulation has been to continue to reduce governmental intrusion in commercial decision-making by airlines, and to recognize and accommodate changes in the marketplace. This policy has been successful in areas such as pricing, route selection, fleet acquisition, and marketing, with positive consequences to many aspects of U.S. carrier economic activity. Airlines now provide seamless, end-to-end service through global systems that depend upon webs of contractual networks among carriers, distribution companies, and service providers. These changes have enabled U.S. airlines to compete more effectively in domestic and international markets.

Moreover, capital markets have evolved and now offer pools of highly mobile capital on a global basis. Innovations in the use of hedge funds, new forms of aircraft financing, and the growing role of international aircraft leasing companies have changed the nature of airline financing, even within the existing regulatory framework. Globalization has redefined the capital marketplace, and driven decisions regarding airline operations. Any regulatory impediments to this crucial access face a heavy burden of justification.

With deregulation, the federal government withdrew restrictions in most economic areas of airline operations, including the areas of domestic pricing and entry. This policy has produced enormous public benefits by helping the aviation industry to grow and compete

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[4] 49 U.S.C. § 40101(a),(e).

effectively in both domestic and international markets. Airlines are now free to enter and exit domestic markets based on their own assessment of economic value and are free to adjust fares to reflect competitive pressures. The Department has also aggressively sought to extend these principles to international markets. Today, the U.S. has open-skies aviation relationships with more than 70 other countries, permitting airlines of both nations much of the same independence from government restrictions in their international operations that U.S. carriers have long enjoyed domestically.

U.S. carriers function in a virtually seamless global environment in virtually every aspect of their operations. However, an interpretation of "actual control" that does not recognize the global and structural changes in international finance and thereby take into account new avenues for investment, potentially excludes billions of dollars of foreign investment from airline capitalization sources. Reducing unnecessary regulatory obstacles to the use of cross-border investment will allow U.S. carriers to become more efficient economically, and allow them to continue to be a major presence in the global aviation marketplace. In some cases, foreign citizens have been unwilling to invest – either in the form of debt or equity – without certain protections commonplace in the financial world. New or expansion-seeking U.S. airlines in this situation have been either precluded from entering the U.S. market or forced to engage in costly and time-consuming restructurings to facilitate the investment.

These limitations and the related uncertainty also restrict the benefits of Open Skies agreements and of statutory deregulation. The industry's ongoing financial difficulties highlight the need to ensure that our actual control policies do not unnecessarily constrain aviation access to capital. Since the year 2000, the U.S. scheduled passenger airline industry has lost nearly $30 billion, an amount equivalent to roughly one-third of the aviation

industry's total annual revenue. Since 2000, more than 100,000 airline employees have lost their jobs. Four major air carriers and several other national air carriers have been operating under Chapter 11 bankruptcy protection and have struggled to find the capital necessary to enable them to exit Chapter 11 protection. The large network air carriers continue to lose hundreds of millions of dollars every quarter. Such circumstances result in reductions in benefits that could be brought to travelers within the United States, as well as between the U.S. and Open Skies countries.

Any refinement to and our articulation of our interpretation of the "actual control" test as it currently exists in precedent and practice, however, must address and satisfy the following issues. First, it must provide guidance to the industry on future transactions. Second, it must allow globalization to take its course and permit the aviation industry to evolve with greater flexibility and more financing options. Third, it must foster robust partnerships with other nations, removing regulatory obstacles to permit the flourishing of a dynamic aviation industry. Fourth, it must come to terms with and adequately address anomalous cases that recently have been brought before the Department. Finally, it must continue to protect vital U.S. interests, such as the Civil Reserve Air Fleet Program, and security and safety policies. We are seeking to address these concerns with proposed language in 14 CFR Part 399. By refining and articulating our interpretation of the actual control requirement, we will ensure that we are effectively meeting our market-oriented statutory objectives, while promoting aviation policies that advance those objectives, and the future needs of the aviation industry and its consumers.

We believe this proposed rulemaking should consider whether the Department's interpretation of "actual control" should be changed to reflect substantial structural changes that have taken place in global financial markets, taking into account whether there is

reciprocity for U.S. investment and an Open Skies agreement governs aviation relations between the United States and the home country of a foreign investor, or any other relevant international legal obligations. This proposal is consistent with our obligation to foster a safe, healthy, and competitive airline industry that will remain capable of supporting U.S. economic growth by meeting the public's transportation needs, while retaining regulatory control over those areas within the appropriate realm of government oversight.[5]

We are proposing to place this guidance in 14 CFR Part 399, which is reserved for general policy statements. This provision is not intended to be procedural, but to provide guidance to air carriers when submitting information to the Department for a fitness determination.

We tentatively find that our interpretation of the actual control test has failed to keep pace with changes in the global economy and evolving financial and operational realities in the airline industry itself, to the detriment of U.S. carriers. In view of the increasingly global character of finance and transportation, two things need to be done: U.S. policy must be more receptive to foreign investment, and broad guidelines need to be published to attract that investment, while at the same time protecting those areas of airline operations where there currently remains significant government involvement or regulation. We propose to adapt our interpretation of how foreign capitalization affects the "actual control" of U.S. airlines to reflect the new realities of globalization in the airline and financial industries. With this new guidance, we are striving to alleviate concerns that air carriers are being barred from a significant source of potential capital. In granting greater access to global capital, we are continuing our policy of allowing the market to operate with minimal regulation. We are

[5] 49 U.S.C. § 40101(a), (e).

proposing to refine and articulate our policy in an effort to provide guidance to air carriers with questions concerning the Department's interpretation of actual control.

Carriers require significant capital investments in facilities, technology, and a variety of commercial arrangements. In their efforts to meet these challenges, U.S. air carriers should have the broadest access to the global capital markets permitted by law, so long as such access does not impinge on those areas of airline operations where there currently remains significant government involvement or regulation. Furthermore, new U.S. air carriers seeking to enter the market should similarly be able to obtain the financial capital necessary to launch their businesses.[6] We tentatively do not believe that "actual control" should be interpreted in a way that needlessly restricts the commercial opportunities of U.S. air carriers and their ability to compete. In the context of several recent cases, where carriers have proposed using new cross-border financing vehicles, we have reviewed our policy and have begun to revise it to account for the ever-changing and increasingly liberalized financial markets. One such case is our recent decision regarding the Hawaiian Airlines reorganization.[7] It is a responsibility of the Department to ensure that the interpretation and application of its statutory obligations do not inadvertently or unnecessarily restrict access to the international capital markets by U.S. air carriers and prevent them from effectively competing in the global marketplace.[8]

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[6] *See* 49 U.S.C. § 40101(a)(13)(encouraging new and small carriers).

[7] *See* Conclusions of the Department of Transportation regarding the citizenship of Hawaiian Airlines, *available at* Issues and Events, *at* http://ostpxweb.dot.gov/aviation/index.html.

[8] *See* 49 U.S.C. § 40101(a)(6)(B) (placing maximum reliance on competitive market forces to attract capital); 49 U.S.C. § 40101(a)(12) (encouraging, developing and maintaining an air transportation system relying on actual and potential competition); 49 U.S.C. § 40101(a)(13) (encouraging entry by new and existing carriers); 49 U.S.C. § 40101(a)(14) (promoting, encouraging, and developing civil aeronautics as a viable, privately owned industry); 49 U.S.C. § 40101(a)(15) (strengthening competitive position of U.S. carriers to ensure parity with foreign carriers).

We have refined the standard used in determining actual control in the past by *ad hoc* adjudications to reflect changing industry and financial circumstances. For example, in the *Northwest/KLM case* we said,

> During the course of these [citizenship] assessments, we have seen the complexity and international makeup of these arrangements increase, new financial instruments emerge, and the interrelationships of these new instruments grow. Based on that experience, we have reexamined our application of the control test in order to reflect more accurately today's complex, global corporate and financial environment, consistent with the requirement for U.S. citizen control. Specifically, we have reviewed the relationship between voting equity, on the one hand, and nonvoting equity and debt, on the other.[9]

A key issue in the liberalization of our control standard is whether to also consider circumstances that apply to certain foreign interests, but not to others. We believe that several considerations militate in favor of doing so — specifically, more latitude with respect to foreign investment should be allowed for a foreign interest whose homeland has both an Open Skies relationship with the U.S. and extends reciprocal investment opportunities with respect to its own airlines to U.S. sources of capital.[10] By this proposal, we are proposing to reduce substantially the significance, for purposes of determining citizenship, of foreign influence over many purely economic decisions, such as choice of markets, type of equipment, and rate-setting. We think it generally inappropriate to extend such latitude to nationals of countries

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[9] *In the matter of the acquisition of Northwest Airlines, Inc. by Wings Holdings, Inc.*, Order Modifying Conditions, Order 91-1-41 (Jan. 23, 1991), at 9.

[10] *See* 49 U.S.C. § 40101(a)(15)(emphasizing U.S. carriers' ability to compete with foreign carriers). The law directs us to consider relevant foreign laws and requirements in carrying out our regulatory responsibilities. 49 U.S.C. § 40105(b)(B).

that resist similar openness in access to aviation markets and in investment opportunities in their own airlines. Section 40101(a)(6) of our statute explicitly directs us to emphasize generally competition and access to capital. Among the policy factors we consider is "placing maximum reliance on competitive market forces . . . to encourage efficient and well-managed air carriers to earn adequate profits and attract capital . . . ."[11] Moreover, just as the United States has certain vital interests that we cannot permit to be compromised by control by foreign interests, such as national security, we also have a basic duty to ensure that our airlines, and indirectly consumers, are not placed at an unfair competitive disadvantage by extending benefits to foreign interests where such benefits are not available to U.S. interests abroad. That would be both unwise and contrary to the purpose and spirit of our statutory policy goals — to recognize and encourage open international markets. We will, of course, also consider any relevant U.S. international legal obligations (*see* 49 U.S.C. 40105(b)).

The law requires U.S. control of U.S.-flag airlines. This has not changed. We do not propose to allow "actual control" to shift to foreign hands. We do propose to ensure that the application of an "actual control" standard results in U.S. citizen control being exercised in those areas of airline operations where there currently remains significant governmental involvement or regulation. Moreover, we want to ensure that the test is not applied so broadly so as to unnecessarily inhibit U.S. carriers' access to the global capital market.

Our proposal would not affect the objective statutory requirements that a corporation must satisfy to qualify as a U.S. citizen, including the requirements that it be organized under the law of a U.S. jurisdiction; that 75 percent of the voting interest be owned or controlled by

[11] By the approach we are proposing here, we seek to balance and promote these considerations. With regard to international transportation, we are further exhorted to negotiate arrangements that provide for "strengthening the competitive position of air carriers to ensure at least equality with foreign air carriers . . . ." *Id.*, § 40101(e)(1). It is in keeping with our goals here to extend the benefits of this liberalization to countries that support this policy, but not to those that resist it.

U.S. citizens; and that the President and two-thirds of the managing officers and directors be U.S. citizens. These standards are mandated by law and shall continue to be rigorously enforced, unless and until Congress changes them.

In considering what areas of airline structure and finance should remain under the existing rubric of "actual control" we are mindful of certain important objectives. The first is the requirement that any U.S. carrier must maintain vigorous compliance with safety and security requirements. Similarly, U.S. carriers must be able to continue to incur and honor obligations made directly to the U.S. Government, in particular the Civil Reserve Air Fleet program administered by the U.S. Department of Defense. These are areas in which, despite economic deregulation, there continues to be significant federal government regulation and involvement.[12]

This proposal also retains the requirement that U.S. citizens have control (*i.e.,* the ability to make decisions that are not subject to substantial influence by foreign interests) over the creation and amendment of the organizational documents (such as the charter, certificate of incorporation and by-laws, and/or membership agreement) of the governing entity. This, of course, does not mean that the actual draftsman in a law firm or corporate legal department need be a U.S. citizen. Rather, such "organic" documents must clearly reflect, by both genesis and content, initial and continued actual control by U.S. citizens. Foreign citizens may hold rights essential to protect their financial interests — for example, provisions requiring concurrence before a company may enter bankruptcy or be dissolved — but the fundamental organization of the company must remain in U.S. citizen hands.

[12] *See* 49 U.S.C. § 40101(a)(1)-(3)(mandating safety as the highest priority) *and* § 40101(a)(7)(mandating regulatory system responsive to the needs of the national defense).

With these considerations in mind, we propose a policy statement setting forth the criteria that will be used to determine whether an air carrier is under the "actual control" of U.S. citizens.

With this refinement, responsibility for corporate documents and for policies and procedures related to safety, to security, and to CRAF must still be under the control of U.S. citizens to the extent that they are today. This approach will allow U.S. airlines to benefit from increased access to the foreign capital markets while ensuring that U.S. citizens continue to exert control in areas where significant government regulation and oversight remains.

We recognize that practitioners will need guidance on the implementation of this policy in the context of actual cases, and we encourage consultation with the Department before any irrevocable decisions are made, as is customarily done now. We believe, however, that examples of how the new policy would apply may be useful. In offering such examples, we caution as always that no "template" is possible, and that each case will continue to be examined on its own unique merits.

In one case, foreign interest F, a citizen of an Open-Skies partner, will own an interest in U.S. air carrier A, including up to 25% of the voting stock. Two of A's seven directors will represent F, and three of A's twelve senior management officials will be nominated by F, so that there is compliance with the statute's numerical requirements. One of these F nominees will be in charge of the airline's day-to-day operations, and another will head a committee whose responsibility in setting market entry strategy; both will have influence in the purchase of aircraft. In the past, such responsibilities would have raised actual control issues. Under the proposed policy they would not, absent any other indicia of control, such as control over matters having an impact on CRAF participation, safety, security, by-laws or organizational documents.

In a second example, foreign interest X, also a citizen of an Open-Skies partner, would have similar participation in U.S. air carrier B. In contrast to the first example, however, X's homeland declines to extend reciprocal investment opportunities to U.S. air carriers and other U.S. interests, and there are no other relevant international legal obligations. X and B would therefore be subject to our traditional control analysis, including the question of unacceptable influence by officers nominated by X.

We invite comments on our proposed policy statement on foreign investment in U.S. air carriers. Among the specific issues that we are interested in receiving comments on is whether reciprocal access to investment in other countries' airlines should be required in order to take advantage of the revised interpretation of "actual control."

Part 204 Modifications

In addition to the policy language we are proposing, we are also proposing minor changes to Part 204 that will correct typographical errors and update sections in compliance with the new statute.

In § 204.1, we propose to add a sentence that will reference the new Part 399 language so that air carriers will be directed to the new policy. In § 204.2, we propose to amend the definition of "citizen of the United States" to mirror the language that is now contained in 49 U.S.C. 40102(a)(15). The definition in the statute was amended by Congress in 2004 to include the phrase "which is under the actual control of citizen of the United States" in the part of the definition concerning corporations. We believe that the regulations should mirror the text of the statute as it is currently written. Finally, we are also proposing minor changes to § 204.5 that will clarify language in paragraph (a)(2); delete a typographical error in

paragraph (b); revise the address in paragraph (c); and adds a new paragraph (d) that replaces the last sentence of paragraph (c).

We believe that these amendments to Part 204 will make the regulations easier understood by air carriers consulting the sections while submitting information to the Department.

RULEMAKING ANALYSES AND NOTICES

Executive Order 12866 (Regulatory Planning and Review) and DOT Regulatory Policies and Procedures

Executive Order 12866, Regulatory Planning and Review, directs the Department to assess both the costs and the benefits of a regulatory change. We are not allowed to propose or adopt a regulation unless we make a reasoned determination that the benefits of the intended regulation justify the costs. Our assessment of this rulemaking indicates that its negative economic impact is minimal because the rule will not impose any new costs on the affected certificated and commuter air carriers. This rulemaking is considered significant under DOT Policies and Procedures and E.O. 12866 because of public interest. It was reviewed by the Office of Management and Budget under Executive Order 12866.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA)(5 U.S.C. 601-612), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996, requires federal agencies, as part of each proposed rule, to consider regulatory alternatives that minimize the impact on small entities while achieving the objectives of the rulemaking. This proposed rule clarifies and codifies the Department's practice concerning its interpretation of "actual control" in determining air carrier fitness/citizenship to receive or retain a certificate of public

convenience and necessity or commuter authority. We certify that this action will not have a significant economic impact on a substantial number of small entities.

Trade Impact Assessments

The Trade Agreement Act of 1979 prohibits federal agencies from establishing any standards or engaging in related activities that create unnecessary obstacles to the foreign commerce of the United States. Legitimate domestic objectives, such as safety, are not considered unnecessary obstacles. The statute also requires consideration of international standards and, where appropriate, that U.S. standards be compatible. The Department has assessed the potential effect of this rulemaking and has determined that it will have no effect on any trade-sensitive activity.

International Compatibility

In keeping with U.S. obligations under the Convention on International Civil Aviation, it is the Department's policy to comply with International Civil Aviation Organization (ICAO) Standards and Recommended Practices to the maximum extent practicable. The Department has determined that there are no ICAO Standards and Recommended Practices that correspond to these proposed regulations.

Unfunded Mandates Reform Act of 1995

The Unfunded Mandates Reform Act of 1955 (the Act) is intended, among other things, to curb the practice of imposing unfunded Federal mandates on State, local, and tribal governments. Title II of the Act requires each Federal agency to prepare a written statement assessing the effects of any Federal mandate in a proposed or final agency rule that may result in an expenditure of $100 million or more (adjusted annually for inflation) in any one year by State, local, and tribal governments, in the aggregate, or by the private sector; such a mandate

is deemed to be a "significant regulatory action." This proposal does not contain such a mandate. The requirements of Title II of the Act, therefore, do not apply.

Executive Order 13132, Federalism

This action has been analyzed in accordance with the principles and criteria contained in Executive Order 13132, dated August 4, 1999 (64 FR 43255). This proposed rule does not have a substantial direct effect on, or significant federalism implications for the States, nor would it limit the policymaking discretion of the States.

This proposed rule would not directly preempt any State law or regulation, nor impose burdens on the States. This action would have not a significant effect on the States' ability to execute traditional State governmental functions. The agency has therefore determined that this proposal does not have sufficient federalism implications to warrant the preparation of a federalism summary impact statement.

Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501 et seq.) requires federal agencies to obtain approval from the Office of Management and Budget (OMB) for each collection of information they conduct, sponsor, or require through regulation. The agency has determined that the proposed rule would not impose any additional requirements, but rather serves to codify our existing procedures. Thus, there is no change in the paperwork collection as currently exists.

List of Subjects

14 CFR Part 204

Air carriers, Reporting and recordkeeping requirements

14 CFR Part 399

Administrative practice and procedure, Air carriers, Air rates and fares, Air taxis, Consumer protection, Small businesses

For the reasons stated in the preamble, the Department proposes to amend 14 CFR Part 204 and 14 CFR Part 399 as set forth below:

PART 204 — DATA TO SUPPORT FITNESS DETERMINATIONS

1. The authority citation for Part 204 continues to read as follows:

Authority: 49 U.S.C. Chapters 401, 411, 417

§ 204.1 [Amended]

2. Revise § 204.1 to read as follows:

This part sets forth the fitness data that must be submitted by applicants for certificate authority, by applicants for authority to provide service as a commuter air carrier to an eligible place, by carriers proposing to provide essential air transportation, and by certificated air carriers and commuter air carriers proposing a substantial change in operations, ownership, or management. This part also contains the procedures and filing requirements applicable to carriers that hold dormant authority. See § 399.88 for policy statements concerning "actual control" of air carriers.

§ 204.2 [Amended]

3. Revise § 204.2(c)(3) to read as follows:

204.2 Definitions

*****

(c) Citizen of the United States means:

(1) * * *

(2) * * *

(3) A corporation or association organized under the laws of the United States or a State, the District of Columbia, or a territory or possession of the United States, of which the president and at least two-thirds of the board of directors and other managing officers are citizens of the United States, which is under the actual control of citizens of the United States, and in which at least 75 percent of the voting interest is owned or controlled by persons that are citizens of the United States.

*****

§ 204.5 [Amended]

4. Amend § 204.5 as follows:

A. Revise paragraph (a)(2) to read as set forth below;

B. Amend paragraph (b) to remove the "s" after "Carrier" in the third sentence in the reference to "Air Carrier Fitness Division";

C. Revise paragraph (c) to read as set forth below; and

D. Add a new § 204.5(d) before the OMB control number to read as set forth below.

The revisions read as follows:

§ 204.5 Certificated and commuter air carriers undergoing or proposing to undergo a substantial change in operations, ownership, or management.

(a) * * *

(1) * * *

(2) The change substantially alters the factors upon which its latest fitness finding is based, even if no new authority is required.

(b) * * *

(c) Information filings pursuant to this section made to support an application for new or amended certificate authority shall be filed with the application and addressed to Docket Operations, U.S. Department of Transportation, 400 Seventh Street, SW, PL-401, Washington, DC 20590.

(d) Information filed in support of a certificated or commuter air carrier's continuing fitness to operate under its existing authority in light of substantial changes in its operations, management, or ownership, including changes that may affect the air carrier's citizenship, shall be addressed to the Chief, Air Carrier Fitness Division, Office of the Secretary, U.S. Department of Transportation, 400 Seventh Street, SW, Washington, DC 20590.

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PART 399 – STATEMENTS OF GENERAL POLICY

5. The authority citation for Part 399 continues to read as follows:

Authority: 49 U.S.C. 40101 *et seq.*

§ 399.88 [New]

6. Add a new § 399.88 to read as set for below:

§ 399.88 Actual control of U.S. air carriers.

(a) *Applicability.* This policy shall apply to all direct air carriers submitting information to the Air Carrier Fitness Division under Part 204 of this title, with respect to its status as a "Citizen of the United States" as defined in 49 U.S.C. 40102(a)(15), of the Act. This policy shall only apply to the interpretation of "actual control" contained in 49 U.S.C. 40102(a)(15)(C) in determining air carrier fitness/citizenship to receive or retain a certificate of public convenience and necessity.

(b) *Policy.* In cases where there is significant involvement in investment by non-U.S. citizens and either where their home country does not deny citizens of the United States reciprocal access to investment in their carriers and does not deny U.S. carriers full and fair access to their air services market, as evidenced by an Open Skies agreement, or where it is otherwise appropriate to ensure consistency with U.S. international legal obligations, the Department will consider the following when determining whether U.S. citizens are in "actual control" of the carrier:

(1) all necessary organizational documentation, including such documents as charter of incorporation, certificate of incorporation, by-laws, membership agreements, stockholder agreements, and other documents of similar nature. The documents will be reviewed to determine whether U.S. citizens have and will in fact retain actual control of the air carrier through such documents.

(2) the carrier's operational plans and actual operations to determine whether U.S. citizens have actual control with respect to:

(A) decisions whether to make and or continue Civil Reserve Air Fleet (CRAF) commitments, and, once made, the implementation of such commitments with the Department of Defense;

(B) carrier policies and implementation with respect to transportation security requirements specified by the Transportation Security Administration; and

(C) carrier policies and implementation with respect to safety requirements specified by the Federal Aviation Administration.

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Michael W. Reynolds
Acting Assistant Secretary for
Aviation and International Affairs